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CITATIONS

Cases:

Colgate-Palmolive-Peet Co. v. *United States*, 130 F. 2d 913, pending this Term, Nos. 38 and 39 — 3, 7, 11

Statutes:

Revenue Act of 1934, c. 277, 48 Stat. 680, Sec. 602½ — 3, 8, 9, 13

Revenue Act of 1936, c. 690, 49 Stat. 1648, Sec. 702 — 8, 14

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Treasury Regulations 48, Art. 5 (as amended by T. D. 4695, XV–2 Cum. Bull. 324 (1936)) — 8, 15

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In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 393

DURKEE FAMOUS FOODS, INC., PETITIONER

v.

CARTER H. HARRISON, COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF ILLINOIS

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (R. 426–445) is reported at 46 F. Supp. 642. The opinion of the Circuit Court of Appeals (R. 471–486) is reported at 136 F. 2d 303.

JURISDICTION

The judgments of the Circuit Court of Appeals were entered June 1, 1943 (R. 486–487). A clarifying amendment, which also consolidated the two judgments into a single judgment, was entered by the Circuit Court of Appeals August 12, 1943

(R. 489–490). The time within which to file a petition for certiorari was extended to October 1, 1943, by an order of a Justice of this Court entered August 25, 1943. The petition was filed September 29, 1943. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the tax imposed by Section 602½ of the Revenue Act of 1934 is measured upon the total quantity of oil which enters into the first domestic processing, including the so-called M. I. U. content and the free fatty acids, or whether the tax is measured upon that quantity of oil less the M. I. U. and free fatty acids removed during the processing.

2. Whether a processor who neutralizes, washes, bleaches, and deodorizes oils with respect to which the tax is imposed by Section 602½ of the Revenue Act of 1934, and who, as required by the Act, has paid the tax upon the first domestic processing, in this case the neutralizing process, is entitled to an allowance for oil lost during all or any of these processings.

3. Whether, in the case of a processor who neutralizes, washes, bleaches, and deodorizes the oils designated by Section 602½ of the Revenue Act of 1934 and who further processes the resulting oils in the preparation of food products, the tax-

able first domestic processing is the neutralizing process or is the first process which follows the deodorizing process.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra,* pp. 13–15.

STATEMENT

The taxpayer, Durkee Famous Foods, Inc., was engaged during the period May 1934 to January 1936, inclusive, in processing coconut oil, palm kernel oil, sesame oil, and sunflower oil at its various plants (R. 16, 33, 38, 84, 296–297). The taxpayer brought two separate suits in the District Court for the Northern District of Illinois for the refund of taxes paid with respect to the processing of these oils under Section 602½ of the Revenue Act of 1934 (R. 2–13, 16–38). The first suit involved the issue of statutory construction presented by *Colgate-Palmolive-Peet Co.* v. *United States,* Nos. 38 and 39, this Term, namely, whether the statutory "first domestic processing" means the first occurring after the effective date of the Act. The second suit, with which we are here concerned, involved several distinct issues. Although the cases were consolidated for trial (R. 49), the issue involved in the first suit was submitted on a stipulation of facts (R. 296–297) and presented only the question of statutory construction referred to, while the issues of the sec-

ond suit were submitted on voluminous documentary and oral evidence and presented numerous questions of both fact and law. The District Court decided for the taxpayer on the issue of the first suit and for the Collector on two of the three principal issues of the second suit (R. 426–445). On appeals by both parties, the Circuit Court of Appeals affirmed as to the first suit and as to the two issues decided in the Collector's favor in the second suit and reversed as to the issue decided in the taxpayer's favor in the second suit (R. 471–486).

The issues presented by the petition for certiorari involve a part of the taxes paid with respect to the processing of some 172,000,000 pounds of coconut oil, palm kernel oil and sesame oil (R. 46–47, 84, 201, 329–425). All of these oils were subjected to the neutralizing, washing and bleaching processes (R. 89, 94–96), taxes having been paid upon the total weight of the oil which entered the first domestic processing, that is, as applied to these oils, the neutralizing process (R. 46–47, 269). A part of the total quantity of approximately 172,000,000 pounds of these oils was sold by the taxpayer at the end of the bleaching process, to manufacturers of pharmaceuticals, cosmetics, and soaps (R. 97). The remainder of the total poundage was subjected by the taxpayer to a fourth operation, known as the deodorizing process (R. 97–98). A second part of the poundage

was sold by the taxpayer at the end of the deodorizing operation to manufacturers of food products (R. 99, 160–161). The balance was further processed by the taxpayer in the preparation of margarine, shortening, and a hard butter for the confectionery trade (R. 46–47, 160–161). The quantities of oil which were sold by the taxpayer and which were retained by it for further processing depended wholly upon market conditions at the time (R. 160).

From the chemist's standpoint, coconut oil, palm kernel oil, and sesame oil consist solely of glycerine and fatty acids in chemical combination (R. 136–137, 179, 247–254, 260–263, 323, 325, 327). As extracted from copra, palm kernels, and sesame seed, respectively, these oils customarily contain a very small percentage of fiber, hair, sand, moisture, etc., known collectively as the M. I. U. content (R. 85, 99–101, 114–116, 205). They also contain free fatty acids in quantities ranging from 5% to 6% in the case of coconut oil and palm kernel oil to about 1% in the case of sesame oil (R. 116–117). These "free" fatty acids are to be distinguished from the fatty acids which are found in chemical combination with the glycerine. Also from the chemist's standpoint, each of these oils, as extracted from copra, palm kernels, and sesame seed, constitutes a "mixture" (R. 117–123, 141, 192, 222).

In the neutralizing process a measured quantity of a caustic, sodium hydroxide, is added to the

oil and reacts with the free fatty acids to form a soap. This results in the separation and removal of most of the free fatty acids, together with about 55% of the so-called M. I. U. content of the oil (R. 89–91, 125–127). The neutral oil—that is, the original oil less most of the free fatty acids and the 55% of the M. I. U. content—is drawn off and subjected to the various succeeding processes (R. 94–99). The remaining 45% of the M. I. U. content, consisting of unsaponifiable substances such as alcohols, resinous matter, gums, etc., remains in the oil throughout the succeeding processes and as sold to the ultimate consumer (R. 126–127). Traces of free fatty acids (between .025% and .05%) also remain in the oil during the subsequent processes (R. 138, 159). If the oil is permitted to stand a substantial period of time following the neutralizing process, free fatty acids will again form due to the deterioration of the oil molecules (R. 159, 185).

It is possible to remove a part of the M. I. U. content of the oils by permitting it to settle out over a period of time; this method is impracticable (R. 92). It is also possible to remove a part of the M. I. U. by the treatment of the oils with bone char and Fuller's earth (R. 91). This method, however, does not remove the free fatty acids (R. 152).

During the neutralizing process, as well as during the washing, bleaching and deodorizing processes, there inevitably occur losses of oil, which

in small quantities settles out with the free fatty acids, sticks to the side of the vat, drains out through leaky valves, is carried away with the water during the washing process, is absorbed by the bleaching ingredient during the bleaching process, or is carried away with the steam during the deodorizing process (R. 91, 95, 96, 98–99, 149). The amount of the oil lost during these processes varies with the efficiency of the operations (R. 190–191).

ARGUMENT

The Collector has filed a petition for certiorari (No. 266, this Term) from the portion of the judgment of the Circuit Court of Appeals which is adverse to him. That petition presents only a question of statutory construction, on stipulated facts, which was decided by the court below in a manner squarely contrary to the decision of the Circuit Court of Appeals for the Third Circuit in *Colgate-Palmolive-Peet Co.* v. *United States,* 130 F. 2d 913 (Nos. 38 and 39, this Term). The present petition, on the other hand, involves several issues wholly distinct from the single issue presented in the Collector's petition. As to these issues, there is no conflict and the decision of the Circuit Court of Appeals was right. We accordingly believe that the present petition should be denied.

1. The oils here involved customarily contain, prior to processing, minute quantities of waste

matter, known as the M. I. U. content, as well as free fatty acids. During the course of the neutralizing operation about half of these waste materials and substantially all of the free fatty acids are removed. Section 602½ of the Revenue Act of 1934 (Appendix, *infra,* pp. 13–14) imposes a tax, not upon the oils as such, but upon their first domestic processing. Consistently with the statute, the regulations have always provided that the measure of the tax is the quantity of oil or oils put into processing. Treasury Regulations 48, Article 5 (Appendix, *infra,* p. 15). Under this issue, the taxpayer does not dispute that the neutralizing processing was properly the first domestic processing. Thus, in arguing that the measure of the tax should exclude the materials removed during the course of neutralizing (Pet. 8–11), the taxpayer in effect is contending that the measure of the tax is the oil which *results from* rather than *enters into* the taxable processing. This, and the several supporting arguments designed to secure this result, conflict with the statute. Moreover, the 1936 amendment (Appendix, *infra,* pp. 14–15), contrary to taxpayer's assertion (Pet. 9–10), strongly supports the Collector's position that the tax is measured upon the total quantity of oil entered into processing, including the customary and usual constituents of the oil. The 1936 amendment for the first time taxed the independent processing of the fatty acids. In so extending the tax Congress recognized, however,

that fatty acids "resulting from" a previous processing taxable under the 1934 Act would already have paid a tax. Accordingly, in order to avoid double taxation, it expressly excluded such fatty acids from the 1936 tax. This understanding of the scope of the 1934 tax is inconsistent with the taxpayer's contention that it should be restricted so as to exclude from its measure the free fatty acids and the other materials which, strictly from a chemist's standpoint, are not oil. The Circuit Court of Appeals correctly held for the Collector on this issue.

2. The taxpayer also contends (Pet. 11–12) that it is entitled to an allowance for oil lost during the neutralizing and subsequent processings. But such losses, which are in extremely small amounts and vary with the efficiency of the operations, all occurred subsequent to the taxable event—the entry of the oil into the first domestic processing. Section 602½ (c) and (d) of the Revenue Act of 1934 allow, in two instances, credit or refund of processing taxes paid, based upon the subsequent disposition of the oil. No such credit or refund is provided as to oil lost subsequent to the taxable event. The taxpayer rather clearly is arguing for an allowance which the statute fails to give. On this, as well as the third issue, both courts below correctly held for the Collector.

3. A "domestic processing," under Section 602½, is a "use" of the oils "in the United

States, in the manufacture or production of an article intended for sale." Some of the oils were neutralized, washed, bleached, and deodorized, and, depending upon market conditions at the time, were further processed by the taxpayer in the preparation of margarine and other food products, which were then sold. As to these oils, taxpayer argues in effect (Pet. 12–14) that there was no "domestic processing" until the processing following the deodorizing processing, on the ground that until then there was no "use" of them in the production of an article (margarine, etc.) intended for sale. The practical importance of this contention is that if the tax can be postponed to the later processing, the removable M. I. U. and free fatty acids will have been eliminated and the measure of the tax reduced. The distinction which taxpayer seeks to draw, however, is baseless, since the neutralizing, washing, bleaching, and deodorizing operations, no less than the subsequent processings, are essential to the production of margarine and the other food products. The statute probably meant to distinguish only between an industrial use and a home use of the oils; certainly the taxable event, when the conditions are otherwise satisfied, does not turn on the *subsequent* use made of the oils, for if this were so the event frequently could not be determined until long after the tax was due. The amendment referred to (Pet. 13) was directed

to an entirely different matter—the tax free processing of certain quantities of Philippine coconut oil—and was rejected without mention of the instant question. Cong. Rec., Vol. 78, Part 6, pp. 6308–6324, 6392.

The taxpayer claims (Pet. 13–14) a conflict on this point between the decision of the courts below and that of the Circuit Court of Appeals for the Third Circuit in the *Colgate* case, *supra*. The claim is unwarranted. This question was neither tendered to, nor decided by, the Third Circuit. The *Colgate* issue, like the issue presented in the Collector's petition for certiorari in No. 266, assumes, in accordance with the stipulation of the parties, that there was a "domestic processing" of the oils both before and after the 1934 Act. The question there is whether, notwithstanding a previous domestic processing, the first domestic processing after the effective date of the Act is taxable.[1]

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[1] It is true that, although the Collector's position is consistent throughout, the taxpayer's position as to the meaning of "domestic processing," under 3, *supra*, is inconsistent with its underlying position on the issue presented in No. 266. This inconsistency was recognized and dealt with by a stipulation of the parties in the District Court (R. 72–73, 231–233). But it is an inconsistency from which the Collector seeks no advantage in No. 266, since he has stipulated (R. 296–297) that the oils there involved received a domestic processing prior to the effective date of the Act, and it is irrelevant to the claim of conflict between the Third and Seventh Circuits.

CONCLUSION

The instant petition presents questions wholly distinct from the single issue of statutory question involved in the Collector's petition in No. 266. The questions presented here were correctly decided by the court below, and there is no conflict. The petition should be denied.

Respectfully submitted.

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OCTOBER 1943.